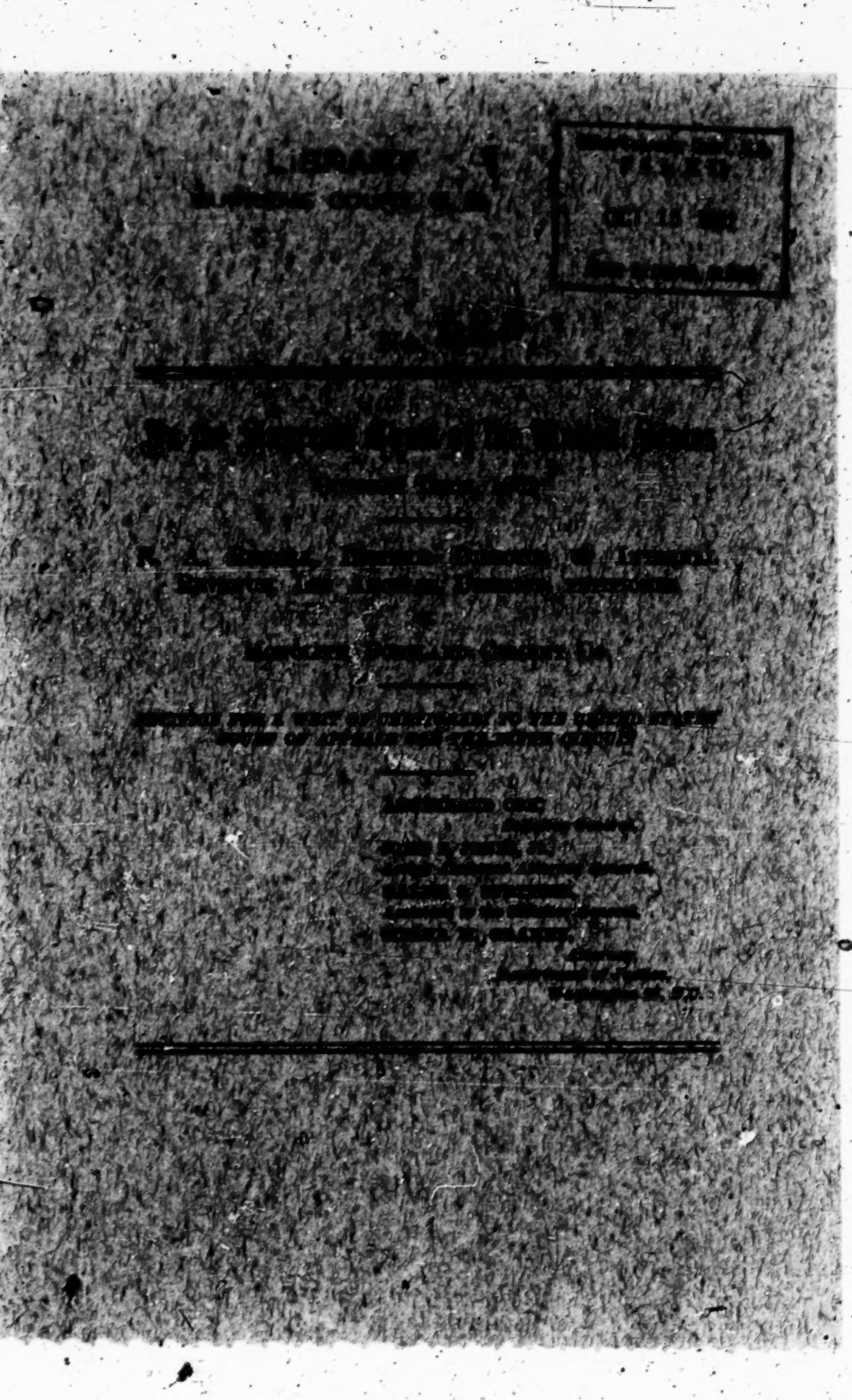

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. ——

R. A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE, LOS ANGELES DISTRICT, PETITIONER

v.

MONOLITH PORTLAND CEMENT CO.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of R. A. Riddell, District Director of Internal Revenue, Los Angeles District, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit in the above-entitled case.

OPINIONS BELOW

The district court's findings of fact and conclusions of law (R. 168–185) are not officially reported. The opinion of the court of appeals (App. A, *infra*, pp. 19–39) is reported at 301 F. 2d 488.

JURISDICTION

The judgment of the court of appeals was entered on March 23, 1962. (App. A, *infra*, p. 40.) A peti-

tion for rehearing *en banc* was denied on May 22, 1962. By orders of Mr. Justice Douglas, entered on August 13 and September 20, 1962, the time for filing a petition for a writ of certiorari was extended to October 16, 1962. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether, for the purpose of computing the percentage depletion allowance on limestone, "mining," as defined in Section 114(b)(4)(B) of the Internal Revenue Code of 1939, includes the processes employed by an integrated miner-manufacturer to manufacture cement.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions and Treasury Regulations are Sections 23 (m) and (n) and 114 (b)(4) of the Internal Revenue Code of 1939 and Section 39.23(m)-1 (e), (f), and (h) of Treasury Regulations 118. They are printed in Appendix B, *infra*, pp. 41–46.

STATEMENT

The respondent (hereinafter called the taxpayer) is an integrated miner-manufacturer engaged in mining limestone from its own quarry and manufacturing it into finished cement at its nearby plant in Monolith, California. (R. 171.) In its 1952 income tax return, it computed its percentage depletion allowance in accordance with the pertinent Treasury Regulations. (R. 175.) After paying its taxes for that year, it filed claims for refund (R. 39–43, 176–177)

and later instituted this suit for refund (R. 3–22)[1] on the ground that its "gross income from mining" (its depletion base) was its gross receipts from sales of finished cement. (R. 6, 12). The government defended the suit on the ground that "mining" terminated with the primary crushing process. (R. 86, 90, 91, 137.) The district court granted (R. 162) a motion for summary judgment filed by the taxpayer (R. 104–105), viewing the issue as one of law (R. 170), but deciding the case without the benefit of this Court's subsequent decision in *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76. The result of the increase in the taxpayer's depletion allowance was a holding that the taxpayer should not have paid any income tax at all for 1952 and was entitled to a refund of taxes in the amount of $186,753.40 plus interest. (R. 178–179.) The court of appeals, notwithstanding this Court's intervening decision in *Cannelton*, affirmed the judgment of the district court.[2] (App. A, *infra*, pp. 19–40.)

The significant facts are undisputed. Limestone is widely distributed in the United States, has the great-

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[1] That portion of the taxpayer's complaint covering the years 1953 and 1954 (R. 22–38) was dismissed on stipulation of the parties (see R. 163–164).

[2] There have been two other issues in the case. The "marble" issue raised by the Government in the trial court as an additional defense, is not raised in this petition. A collateral estoppel issue was raised by the taxpayer in relation to both of the other issues, but both courts below preferred to rest their decisions on the merits. (R. 169–170; App. A, *infra*, p. 39.) In view of this Court's subsequent decision in *Cannelton*, collateral estoppel clearly does not apply to the issue presented on this petition. See *Commissioner* v. *Sunnen*, 333 U.S. 591.

est variety of uses of any rock quarried, and is used more extensively than any other type of stone. (Ex. A, R. 353, p. 25; see also R. 74.) Among other things, limestone is used as the basic, necessary raw material in the manufacture of cement. (R. 62, 113, 114.) The limestone industry is divided into two distinct branches according to usage—(1) dimension stone and (2) crushed and broken stone. (Ex. F, R. 525, p. 1; Pl. Ex. 14, R. 693, p. 2; see also Ex. A, R. 353.) The taxpayer does not mine dimension stone; it blasts the limestone from the face of the quarry and crushes it for use in manufacturing cement. (R. 6–7, 173.)

In 1952 (the taxable year), there were approximately 207,000,000 tons of crushed and broken limestone sold or used by producers in the United States (Ex. A, R. 353, p. 29; Pl. Ex. 14, R. 693, p. 12.) Excluding the substantial tonnage used in manufacturing cement (see Ex. C, R. 463, p. 13) and that used to make lime, which are reported "in terms of finished products" in the Cement and Lime chapters of the Minerals Yearbooks annually issued by the United States Bureau of Mines (Ex. A, R. 353, pp. 1, 29), over 216,000,000 tons of limestone (including chemical and metallurgical grade), with an average value of $1.36 a ton, were sold or used by producers in crushed or broken form in the United States in 1952. (*Id.*, pp. 26–27.) Of that total, over 1,500,000 tons were sold or used by producers in California (in addition to that used to manufacture cement). (*Id.*, p. 26.) There are eight grinding plants in California alone which purchase and process limestone. (Ex. 1, R. 599, p. 15.)

In 1952, the taxpayer sold no limestone in crushed or broken form or in any other form; it used all of its limestone to make finished cement (R. 171), which, as both courts below assumed (R. 171; App. A, *infra*, pp. 21, 22, 26–27), is a "manufactured" product (Ex. C, R. 463, pp. 3, 13; Ex. D, R. 499, p. 1; Pl. Ex. 14, R. 693, p. 14).[*] The district court found that in 1952 "it was not economically or commercially feasible for [the taxpayer] to use any of such limestone in the production of dimension stone, or crushed limestone"—and that "[t]here was not at any time during the taxable calendar year 1952, any commercial market, within the market area available to [the taxpayer], for the limestone extracted and used by [the taxpayer]". (R. 171–173.)

The processes which the taxpayer used in mining its limestone and manufacturing it into cement are correctly set forth in paragraph 12 of the taxpayer's complaint (R. 173), which appears at R. 6–7. Those processes, which the trial court found are normally used in the cement industry (R. 174), may be summarized as follows: blasting the face of the quarry; several crushing processes; transportation to its plant two miles away; blending the limestone with small amounts of clay, silica, iron cinders, and fluorspar; adding water and making a "slurry" of the blended material; grinding the slurry; heating the slurry in a rotary kiln, where the water is evaporated and the remaining material is chemically combined into a dense "clinker"; adding a small amount of gypsum to

[*] The production of cement includes the heating of blended materials in a rotary kiln which causes a chemical change to occur in the materials. (R. 9, 106).

the clinker and grinding it to a very great fineness. At this point, cement has been produced.

The raw materials used by the taxpayer in manufacturing cement included not only limestone but six other materials, *i.e.*,* clay, silica, tufa, gypsum, iron cinders and fluorspar. Two of those—iron cinders and fluorspar—were purchased, rather than mined, by the taxpayer. (R. 146.)

REASONS FOR GRANTING THE WRIT

The decision of the court below is in conflict with the decisions of other courts of appeals on an issue which involves substantial amounts of revenue for the years prior to 1961 and which, despite a statutory amendment, remains of importance to the determination of depletion cases for future years. These reasons alone justify granting a writ of certiorari. There is, however, a more important reason for granting the writ. The Ninth Circuit has failed—perhaps even refused—to follow the plain teaching of this Court's decision in *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, in a context which is indistinguishable. Respect for the orderly processes of resolution of disputed questions of federal law requires the correction of any such marked disregard of this Court's decisions.

1. Section 23(m) of the Internal Revenue Code of 1939† states that in computing taxable net income a de-

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*The amount of each raw material used by the taxpayer in 1952 is stipulated and set forth at R. 146.

†All further statutory references, unless otherwise indicated, are to the Internal Revenue Code of 1939.

duction from gross income shall be allowed for depletion of mines. The allowance for the mineral deposits here in issue is calculated by taking a specified percentage* of the gross income from the property. Section 114(b)(4)(A). "Gross income from the property" is defined by the Code as meaning "the gross income from mining." Section 114(b)(4)(B). "Mining", in turn, is declared "to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *" (*ibid*). The same section lists the limited types of treatment processes which can be considered part of "mining".

There has been a wealth of litigation as to what treatment processes are ordinarily applied to obtain the commercially marketable mineral product in each of a number of areas of mining. This is not surprising: the more income-producing processes that are included in "mining", the greater the income from "mining", and therefore the greater the deduction allowed by the Internal Revenue Code for the depletion of mineral assets.

In *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, this Court undertook to lay at rest the major and most pervasive question in dispute. The Court held that the statutory references to "ordinary treatment processes" and a "commercially marketable mineral product" prescribe an objective standard for

* There is no dispute in the present case as to the appropriate percentage.

determining the cut-off point of "mining" for any given branch of the mining industry. That cut-off is at the point where the mineral first becomes fit for commercial sale, shipment, or use. Thus, the Court attempted to put an end to discrimination among mineral producers in different localities and between integrated and non-integrated miners.

The relevant facts of *Cannelton* were these. The Cannelton company mined fire clay and manufactured sewer pipe from it.[2] The record showed that, although there was a market in which substantial amounts of fire clay was sold (in Brazil, Indiana), Cannelton's costs of mining alone exceeded the market value of the clay at that market and that the cost of transportation to market would have been several times the market value of the clay. In short, there was no market in which Cannelton could, as a matter of commercial realities, sell its clay, for any clay it could sell in the nearest market would be sold at a loss.

Recognizing these facts was, of course, not to say that a sewer pipe manufacturer such as Cannelton was foolish to continue to mine clay when it could be purchased elsewhere at a lower price. The cost of transporting clay from Brazil to its factory would have far exceeded the savings from purchasing the clay. In short, it was economical for Cannelton to supply its own needs as a manufacturer. In this Court's words, Cannelton, as a manufacturer, provided its own market for the product of its activities as a miner.

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[2] Shale in lesser quantities was also involved.

Cannelton contended, and the Seventh Circuit held, that the statutory provisions which base the depletion deduction upon income not only from extraction of a mineral but also from those processes normally applied to the mineral to obtain the commercially marketable mineral product meant that it could base its depletion on income from all those processes which it had to undertake in its particular circumstances to obtain a product which it could sell to others at a profit. Since it could not sell clay to others at a profit, it claimed, and was allowed by the lower courts, a deduction based upon its income from its manufactured product.

This Court reversed unanimously. It held that the statute, which spoke of "the *ordinary* treatment processes *normally* applied by mine owners or operators in order to obtain the commercially marketable mineral product" (emphasis added) and which listed the narrow range of processes it contemplated, was never intended to make the depletable product in any given industry depend upon the peculiar methods of operation of each mine owner. Congress, the Court held, intended to provide a simple workable measure for computing depletion of the mineral asset. It did so by defining the depletion base in terms of the gross income from only those mining and treatment processes which are customarily applied in the industry as a whole prior to sale or shipment of the mineral product. This purpose of estimating the depletion of the mineral asset by reference to its value or proceeds at the first point at which a market for it ordinarily exists would be distorted by including in

the depletion base the value added by processes applied after the mineral has already reached the stage at which it is ready for commercial use.* Moreover, the Court pointed out, harmful discriminations would result if the depletion allowance were permitted to vary with the number of processing steps each miner found it desirable or necessary to undertake prior to a profitable sale of its ultimate product.

Finally, the Court held, the fact that there was no market in which Cannelton could realistically be expected to sell its clay (for any such sale would be at a loss) was irrelevant to a determination of the commercially marketable product on which Cannelton could claim depletion. Cannelton's mineral clay, no less than the product of any other operator of a clay mine, had value as a mineral. "As we see it, the miner-manufacturer is but selling to himself the crude mineral that he mines, insofar as the depletion allowance is concerned." 364 U.S. at 87. Cannelton's depletion allowance should be the same as that which would be allowed to a separate taxpayer that owned Cannelton's mine and sold its product to Cannelton for further processing and fabricating. "We believe that the Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication." 364 U.S. at 89.

In sum, this Court's *Cannelton* decision plainly construed the statutory definition of "mining" as pre-

* In the language of the opinion (364 U.S. at 86), minerals "have passed the 'mining' state on which the depletion principle operates" when they "are in such a state that they are ready for industrial use or consumption * * *."

scribing an objective standard, to be uniformly applied throughout each branch of the mining industry, under which the cut-off point to "mining" is at the stage where, with the application of the *normal* processing techniques appropriate to the particular branch, the mineral *first* becomes suitable for industrial use or consumption (a point which, unless the particular branch of mining industry is completely integrated, will be reflected in sales of the mineral by ordinary, run-of-the-mill miners).

The present case is identical in all material respects. The Monolith Company mines limestone, crushes it, and then transports the crushed product two miles to its plant where additional processing is undertaken and additional materials are added to manufacture cement (R. 173–174). Notwithstanding the district court's finding (R. 171–172) that "[t]here was not * * * any commercial market, *within the market area available to plaintiff*, for the limestone extracted and used by [the taxpayer] * * *" [emphasis added], if the limestone industry as a whole is considered there is incontestably a most substantial commercial market for the sale of crushed limestone. Crushed limestone is therefore, under the holding of *Cannelton*, the "commercially marketable mineral product" with reference to which depletion is computed. To determine Monolith's depletion deduction in terms of its income from the sale of cement accomplishes the very results which this Court held unauthorized in *Cannelton*. It allows the taxpayer to "enjoy, in addition to a depletion allowance on his minerals, a similar allowance on his manufacturing costs, including depreciation on his manu-

facturing plant, machinery and facilities." 364 U.S. at 88. It "would not only give [the taxpayer] a preference over the ordinary nonintegrated miner, but also would grant it a decided competitive advantage over its nonintegrated manufacturer competitor." 364 U.S. at 87. Finally, this Court was speaking of a company such as Monolith when it said, "We believe that the Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication." 364 U.S. at 89.

The Ninth Circuit was not unaware of its departure from *Cannelton* when it allowed Monolith to calculate its depletion on the basis of income from the sale of cement. It acknowledged a "reluctance" to come to its conclusion "because of some doubt if it can be reconciled with the reasoning of the Supreme Court in *Cannelton*." App. A, *infra*, p. 36. Moreover, it openly expressed its disagreement with much of this Court's reasoning in *Cannelton*. See App. A, *infra*, pp. 31–33.

Still, the court of appeals allowed depletion based on manufactured cement. Its only attempt to distinguish *Cannelton* was plainly unsound. Relying upon the district court's finding that there was no "commercial market within the market area available to [the taxpayer] for the limestone extracted," the court of appeals held that, while there was a local market (albeit an unprofitable one) for Cannelton's clay, there was *no* local market for Monolith's crushed limestone. The distinction fails, if for no other reason because this Court made clear in *Cannelton* that an integrated miner-manufacturer is to be viewed as

its own market for the product it mines. But the distinction fails for a more fundamental reason as well. *Cannelton* established that the existence of a commercial market for the sale of a mineral product was only relevant in determining an industry-wide line as the cutoff point for mining.[*] That the statute looks to the general practices of each industry as a whole and not to the existence or absence of a market commercially available to every individual mine operator was the precise holding of *Cannelton*, where the Cannelton Company was the only user of raw fire clay in the limited market area available to the taxpayer in the light of its mining and transportation costs and where, as in the present case, there was no "commercial market *within the market area available to [the taxpayer]*" (emphasis added).

2. As we have shown, the decision below is directly opposed to this Court's decision in *United States* v. *Cannelton Sewer Pipe Co.*, *supra*. It is also in conflict with the decision of the Seventh Circuit in *Commissioner of Internal Revenue* v. *Halquist*, 291 F. 2d 49, which has recently been followed by the Fourth Circuit in *Virginia Greenstone Co.* v. *United States*, No. 8577, decided September 24, 1962 (reprinted in App. C, *infra*, pp. 47–56).

In *Halquist*, the taxpayer removed blocks of stone from quarries and transported them 50 to 250 feet away where they were cut into regular shapes for

[*] In fact, the existence of a substantial market furnishes "conclusive proof" (364 U.S. at 86) that the mineral has "passed the 'mining' state on which the depletion principle operates" (*Ibid.*).

later sale and use as veneer stone. Because 40 to 50% of the weight of the blocks was lost in the processes of cutting, the blocks could not be sold in substantial quantities prior to cutting, for sales at this stage would entail costly transportation of material which would later prove to be largely waste. The taxpayer contended that *Cannelton* did not apply in a situation where there is no commercial market available to the taxpayer for the sale of his mineral product (there, uncut stone blocks). The Seventh Circuit rejected this argument, the same as that made by Monolith below, and held that rough uncut blocks were the "commercially marketable" product, stating (*id.* at 52):

> * * * Lacking local or area sales of the precise stone in Halquist's quarries to establish the cutoff point when the mineral first becomes suitable for industrial use or consumption, we must have recourse to the recognized branch of the mining industry to which Halquist may be assigned.
>
> * * * The evidence * * * shows that in typical dimension stone mining, rough blocks are removed and sold for process in substantial quantities. Cannelton prescribes an objective, standard cutoff point to be uniformly applied throughout each particular branch of the mining industry.

It added that, as in *Cannelton*, the taxpayer should be regarded as selling its mineral product to itself for later processing.

In *Virginia Greenstone Company* v. *United States, supra,* the Fourth Circuit reached the same result relying upon the *Cannelton* and *Halquist* cases. It held that the sole miner and consumer of a stone product called "greenstone", which is used for ornamental and dimension-stone purposes, must calculate its income from mining on the basis of the uncut, unfinished quarry blocks of greenstone it removed, although there was neither a local nor a national market for the sale of these blocks. Quarry blocks of other mineral materials are sold for the same purposes as greenstone and these sales, the court held, establish the commercially marketable mineral product for the dimension stone industry. "The result is", it concluded, "that the taxpayer must be regarded as having sold the quarry blocks to itself and is required to compute allowable percentage depletion on the gross income constructively received upon such sales."

3. Although the depletion provisions of the statute were amended in 1960 and the amendments have expressly limited the treatment processes includible within the definition of mining for taxable years after 1960, this Court's decision in *United States* v. *Cannelton Sewer Pipe Co., supra,* and the erroneous interpretation of that decision by the court below remain applicable to a substantial volume of litigation for the years prior to 1961. Presently pending are suits involving

almost $14,000,000 in tax revenue.[10] This figure does not, of course, take into account those taxpayers who are in a position to file new refund claims for years prior to 1961 which are still open under the applicable limitations provisions.[11] This volume of litigation and the large amounts of revenue which are involved fully justify review of a decision flagrantly disregarding the mandate of *United States* v. *Cannelton Sewer Pipe Co.*, *supra*.

4. The issue involved in the present case will remain of importance for years after 1960 under the amended depletion provisions of the Internal Revenue Code. The Gore Amendment, 74 Stat. 290, 291–293, eliminated the Code's general definition of mining as including those "ordinary treatment processes norm-

[10] The following is a brief summary of pending litigation, showing the number of suits and approximate amounts involved:

Limestone, including that mined by four cement companies—14 suits	$4,000,000
Salt—three suits	5,700,000
Gypsum—two suits	1,800,000
Phosphate rock—two suits	500,000
Silica—three suits	1,600,000
	13,600,000

[11] While, in general, any taxpayer who is not barred by a limitation provision may file new claims for refund for years prior to 1961, relying upon the decision below, the threat is more limited in the cement industry. The statutory amendments in 1960 included an elective provision under which cement manufacturers could choose to use a pre-kiln cut-off point for *all* open tax years prior to 1961. 74 Stat. 1018. Since all but about six cement manufacturers made this election, only these six (of which Monolith is one) can file additional refund claims for years prior to 1961 on the strength of the decision below.

ally applied by mine owners or operators in order to obtain the commercially marketable mineral product." "Mining" is now defined simply in terms of the specific treatment processes which had previously been listed in the 1939 and 1954 Codes, plus certain additional processes for cement manufacturers and some consumers of clay.

The amendment does not, however, eliminate the necessity of determining the "cut-off" point for mining in terms of the legislative history reviewed in *Cannelton* and in terms of the *Cannelton* decision itself. For example, in the case of minerals which are customarily sold in the form of a crude mineral product, "mining" is defined as including extraction plus "sorting, concentrating, sintering, and substantially equivalent processes to bring to shipping grade and form." Since this language is substantially the same as that previously contained in the 1939 and 1954 Codes, the *Cannelton* decision will continue to provide the most important guide to those processes which are permissible "to bring [the mineral] to shipping grade and form." To cite but one specific example, the *Cannelton* decision will determine the "cut-off" point for the "mining" income of a mine operator who sells and ships a crushed stone (such as limestone) in any of a number of progressively smaller sizes which are obtained by the application of machinery and labor in successive crushing processes. Cf. *Riddell* v. *California Portland Cement Co.*, 297 F. 2d 345 (C.A. 9) and *Fannin Investment Co.* v. *United States*, 197 F. Supp. 693

(N.D. Ga.); but cf. *Bookwalter* v. *Centropolis Crusher Co.*, 305 F. 2d 27.[12]

CONCLUSION

For the reasons stated, this petition for a writ of certiorari should be granted, the judgment below reversed and the case remanded for disposition in accordance with *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

JOHN B. JONES, JR.,
Acting Assistant Attorney General.

RALPH S. SPRITZER,
Assistant to the Solicitor General.

MELVA M. GRANEY,
Attorney.

OCTOBER 1962.

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[12] In *Bookwalter* v. *Centropolis Crusher Co.*, *supra*, the Eighth Circuit held that the "mining" of limestone of chemical and metallurgical grade includes all of the processes which the particular taxpayer employed to process its limestone into eight different graded sizes, including finely ground, although the taxpayer itself sold 80 percent of its limestone in crushed form without fine grinding. While we regard this decision as incorrect, we have not petitioned for certiorari because the record does not present the relevant issues with sufficient clarity.

APPENDIX A

United States Court of Appeals for the Ninth Circuit

No. 16914

R. A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE, LOS ANGELES DISTRICT, APPELLANT

vs.

MONOLITH PORTLAND CEMENT CO., APPELLEE

Mar. 23, 1962

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

Before: BARNES, HAMLIN and JERTBERG, *Circuit Judges.*

BARNES, *Circuit Judge:*

This is another of the "statutory percentage mining depletion allowance" cases, involving taxpayer's 1952 return. We have for consideration the affect on this case, if any, of *United States* v. *Cannelton Sewer Pipe Co.*, 1960, 364 U.S. 76, as well as the affect of the previous *Monolith* decision (*Monolith Portland Cement Co.* v. *United States*, 9 Cir. 1959, 269 F. 2d 629),[1] determining the same taxpayer's 1951 liability.

[1] Hereinafter referred to as the "first *Monolith* case" or the "1951 proceedings."

An income tax liability of $156,286.65 shown on appellee's[1] 1952 return was paid by taxpayer in 1953. An additional $25,396.60, plus interest of $5,002.43, was assessed against it and paid in 1956. Taxpayer filed, on or about February 24, 1956, a timely claim for refund of $29,070.81 in taxes paid for 1952, which was disallowed by appellant.[2] Taxpayer and appellant executed a timely extension of the period of limitations for the calendar year 1952; within six months thereafter, taxpayer filed two more claims for refund in the amounts of $181,683.24 and $82,612.44 respectively, which were neither allowed nor disallowed. Within the time provided in Section 3772 of the Internal Revenue Code of 1939,[3] taxpayer brought this action in the district court for a refund of taxes which included a claim for taxes paid in 1952 in the amount of $181,753.30.[4] Jurisdiction was conferred upon the district court by Section 1346, Title 28, United States Code. Judgment in favor of the taxpayer in the principal amount of $181,753.40, plus interest, was entered on December 17, 1959. A timely notice of appeal was filed by the government.[5] This court has jurisdiction to review the judgment entered in the district court by virtue of Section 1291 of Title 28, United States Code.

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[1] Hereinafter sometimes referred to for convenience as "taxpayer."

[2] Hereinafter sometimes referred to for convenience as the "government."

[3] Unless otherwise specifically noted, all references to "Section" or "Code" shall mean a section of, or the Internal Revenue Code of 1939.

[4] The complaint contained five causes of action, the last four of which claimed refunds for the years 1953 and 1954; the last four causes of action were dismissed pursuant to stipulation of the parties.

Taxpayer filed a motion for summary judgment below, and pursuant thereto, the district court considered the taxpayer's motion, its affidavits, the statement of undisputed facts and the stipulations between the parties, the government's affidavits, admissions in its answer and its answers to taxpayer's request for admissions and interrogatories, and, in addition, took judicial notice of the first *Monolith* case (which was between parties in privity involving the year 1951). The district court held that the 1951 proceeding was *res judicata* as to all issues but, preferring not to rest its decision solely on that ground, also decided the merits in favor of taxpayer, stating that there was no genuine disputed issue of fact and that the case was an appropriate one for summary judgment because the issues were of law rather than of fact and that in any event, since the underlying and evidentiary facts were admitted and undisputed, all that remained was to apply the proper legal principles to undisputed facts. Summary judgment was entered in favor of the taxpayer and the government appealed.

The facts as found by the district court may be summarized as follows:

Taxpayer is a Nevada corporation which has its principal office in Los Angeles, California, and is engaged in the manufacture and sale of finished cement in its plant at Monolith, California. In connection with that plant and immediately adjacent thereto (within less than fifty miles) the taxpayer operates an extensive mineral deposit known as its Monolith quarry. During the year in question taxpayer extracted limestone from its quarry which it used to make cement in its plant. All of the extracted limestone was used by the taxpayer exclusively for that purpose.

In the process of making cement, taxpayer added to the limestone small amounts of certain other materials which it mined, as well as some purchased materials. The processes used by taxpayer in making cement were those normally applied in the cement industry by cement manufacturers having deposits similar to taxpayer's.[4]

During 1952 it was not economically or commercially feasible for the taxpayer to use any of its limestone in the production of dimension stone or crushed stone.

The taxpayer's gross sales of finished cement for the year 1952 amounted to $8,393,507.11. The elimination therefrom of amounts attributable to certain operations or practices which the district court found were not ordinary treatment processes, such as bagging,[5] leaves a figure of $6,565,070.44 which the district court called taxpayer's "gross income from mining."

The limestone mined by taxpayer in 1952 and used by it to make finished cement came from the same quarry from which the taxpayer obtained the limestone it used in 1951 and was substantially identical in chemical content to such 1951 limestone. It is stipulated that taxpayer's limestone deposit "is a metamorphosed recrystallized limestone."

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[4] In the present case the district court incorporated by reference its findings of fact in the first Monolith case to the extent not inconsistent with its other findings of fact in the instant case.

[5] The excluded items are as follows: the cost of bags or sacks, placing and shipping the cement in bags or sacks, the operation of a cattle ranch, certain royalties, the allowance of trade discounts, contract trucking and fleet trucking cost, rail freight costs, and warehouse and bulk storage plant costs at distribution points away from the taxpayer's cement plant.

During the year 1952 the limestone in taxpayer's deposit was commonly regarded as and understood to be either "calcium carbonates" or "chemical grade limestone" and was not commonly regarded as or understood to be "marble" or "stone." During the year 1952 the limestone was either "calcium carbonates" or "chemical grade limestone" within the commonly understood commercial meaning of those terms.

The district court held that the taxpayer's limestone was "calcium carbonate" or "chemical grade limestone;" that it was unnecessary to determine which in view of the fact that the percentage depletion allowance is limited to fifty per cent of the net income from mining (which here means taxpayer could not take the higher depletion allowance for "chemical grade limestone" even if its stone were to be found to be so classified); that taxpayer's 1952 "gross income from mining" (its depletion base) was $6,565,070.44; that its percentage depletion allowance, as limited to fifty per cent of its net income from mining, was $463,739.44; and that it therefore should have paid no income tax in the year 1952. Judgment was accordingly entered in favor of taxpayer for a refund of taxes in the amount of $186,753.40, plus interest.

Appellant urges that the district court erred in the following respects:

1. In holding that the taxpayer's limestone is either "calcium carbonates" or "chemical grade limestone" rather than "marble" within the meaning of Section 114(b)(4)(A) of the Internal Revenue Code of 1939 and that the taxpayer's percentage depletion allowance therefore need not be computed by using the lesser 5 per cent rate.

2. In holding that, within the meaning of Code Section 114(b)(4)(B), "mining" includes all of the processes which the taxpayer used in making cement and that the taxpayer's finished

cement in bulk is the "commercially marketable mineral product" to which mining extends and on which the taxpayer is entitled to depletion. In this connection, the court also erred in failing to hold that "mining" only extends to crushing the limestone (properly classified as marble), that the other minerals added to the limestone in making cement were not shown to be depletable, and that crushed limestone (properly classified as marble), is the "commercially marketable mineral product" to which mining extends and on which the taxpayer is entitled to depletion.

3. In holding that the doctrines of *res judicata* and collateral estoppel bar consideration of issues 1 and 2 on their merits.

4. In awarding summary judgment on issues 1 and 2.

As Judge Magruder points out so clearly in his *Dragon Cement Company* v. *United States* opinion (1 Cir. 1957, 244 F. 2d 513, *cert. denied*, 355 U.S. 833):

> [T]he allowance for depletion has been a controversial subject for years, and officials of the executive branch have sought from time to time, with conspicuous lack of success, to persuade the Congress to eliminate some of its alleged overgenerous features. See Mertens, Law of Federal Income Taxation § 24.04 (1954). We are not concerned with the wisdom or policy of the statutory allowance, once we are sure what the allowance is, for it is plainly our judicial function merely to apply the allowance as Congress wrote it and meant it. (*Id.* at 514.)

The *Dragon Cement* opinion then states the background that must be kept in mind before we meet the peculiar problem inherent in the mining of raw

material from which cement is made, as distinguished from other "ores" or "minerals."

"The need for and fairness of some allowance for depletion proceeds from the fact that the production of income through the exploitation of natural resources is accompanied by an inevitable consumption of capital in the form of the gradual exhaustion of the natural resource being exploited. Thus the allowance serves to offset the injustice of classifying only as income what might be regarded as income commingled with return of capital, and serves also as an incentive to encourage capital expenditures in the direction of discovery and exploitation of natural resources.

"Of the three types of depletion allowance prescribed at various times by the Congress, percentage depletion (with which we are now concerned) is to be contrasted with cost depletion and discovery depletion. Cost depletion, based upon the cost to the taxpayer of the particular deposit, seeks to return to the taxpayer free of tax that portion of his cost attributable to the amount of the deposit used up in earning the income on which he is taxed during a given taxable year. Discovery depletion seeks to reward the taxpayer for the discovery of unknown natural deposits, and has usually been based upon the fair market value of the deposit within thirty days after the date of its discovery. By the third type of depletion allowance, percentage depletion, the Congress hoped to furnish an easily computable allowance that would avoid many of the complications arising in connection with the computation of cost or discovery depletion. Percentage depletion is based upon a fixed percentage of the income realized during the taxable year from the exploitation of a piece of property, the percentage varying, somewhat arbitrarily, depending upon the kind of deposit involved.

"With the gradual enlargement of the categories of mineral properties to which the percentage depletion became applicable, the Congress has at the same time automatically eliminated discovery depletion in respect to such deposits. In general, percentage depletion has remained as an alternative to cost depletion, so that even if the taxpayer fails to establish the cost of the property, he nevertheless may be entitled to the allowance of a percentage depletion. It is also true, as pointed out in

We next note that the *Dragon Cement* case, *supra*, like our instant case, and unlike *Cannelton*, *supra*,

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Mertens, Law of Federal Income Taxation § 24.31a (1954), 'that through percentage depletion a taxpayer may recover more than his cost over the life of the property.'

"For present purposes we need to go no further back than to the provisions of the Internal Revenue Code of 1939.

"Section 23 of this Code contained the following (53 Stat. 12, 14):

"'SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"'In computing net income there shall be allowed as deductions:

* * * * * * *

"'(m) *Depletion.* In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

"'(n) *Basis for Depreciation and Depletion.* The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.'

"Section 114(b)(4) stated as the general rule (53 Stat. 45) that the basis for the depletion allowance should be the adjusted basis in § 113(b) for determining gain upon the sale or other disposition of such property, except as otherwise provided in the ensuing paragraphs numbered (2), (3) and (4). Paragraph (2) related to discovery value in the case of certain mines. Paragraph (3) gave a percentage depletion formula for oil and gas wells. Paragraph (4) gave percentage depletion formulas for coal, metal, and sulphur mines (but not including the type of deposit involved in the case at bar), and provided allowances based upon a prescribed percentage 'of the gross income from the property during the taxable year'.

"The phrase 'gross income from the property' was undefined as it appeared in the 1939 Code. It thus had a lurking ambiguity where the mine owner customarily performed more than merely extractive operations before realizing any income; in such cases, would the basis for the depletion allowance include gross in-

involves the raw material from which cement is "manufactured."

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come from what in other contexts might be described as manufacturing operations upon the extracted property? The statute did not make this point clear, and Regulation 111, as originally issued, naturally sought to narrow the scope of the allowance.

"In the Revenue Act of 1943 (58 Stat. 45) the Congress attempted to resolve this ambiguity by inserting a definition of 'gross income from the property' in a new § 114(b)(4)(B), reading in part as follows:

"'(B) *Definition of Gross Income From Property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators, in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude miners' product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores.'

"It is apparent that the Congress intended not to limit the computation of the percentage depletion allowance to the gross income attributable to purely extractive processes, for the deposit when thus first extracted might not be in a commercially

Turning to *Cannelton*, we first note that it differs in its facts from our instant case in that in *Cannelton* (a) there was a local market in "ground fine clay," the first "commercially marketable product" originally claimed by taxpayer (although subsequently taxpayer claimed the first commercially marketable product was the finished product, *i.e.*, sewer pipe); (b) there was

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marketable form, and might require further processing. Congress accomplished this by providing for the first time a general formula, and by giving nonexclusive illustrations of processes included in the phrase 'ordinary treatment processes'. See §613(b) of the Code of 1939, 53 Stat. 470. The general formula, which of course is controlling, is that the basis for computing the percentage depletion allowance shall be the 'gross income from mining', defined as including 'not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products.' Thus we must look to see what processing is normally undertaken by a mine owner or operator in order to obtain a commercially marketable product, and when such a salable product is obtained, then the gross income from the sale of such product is the base upon which to apply the percentage depletion allowance. That these 'ordinary treatment processes' are not necessarily limited to those processes which leave the extracted deposit in its natural state is clear from the inclusion, as an illustration in §114(b)(4)(B), of the process of furnacing quicksilver ores, which involves a chemical change.

It would also be helpful, in a preliminary way, to observe that the depletion allowance is not an allowance upon any process, whether a mining process or a manufacturing process. Nor is it an allowance, as such, upon any product. Instead, it is an allowance to the mine owner designed as a simple means to diminish his taxable income from the exploitation of a natural resource which is necessarily exhausted in the process. In making this allowance, the Congress has elected not to limit the deduction in all cases to the taxpayer's actual cost or other basis in the land from which the ore or mineral is extracted. To supply a simpler rule, the Congress has turned more and

"a substantial market for the raw mineral" in Indiana and Kentucky, even though not marketable at a profit.

Next, we know that (1) *Cannelton* holds that "marketability of the raw material" at a profit is of no significance; (2) the "ordinary treatment processes" to be included in the depreciable value are not those of the fully or partially integrated miner, but they

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more to the method of percentage depletion, which differs from both cost and discovery value depletion in that it is measured by an arbitrary percentage of gross income from the property, without regard to the taxpayer's cost or discovery value.

"From the foregoing it is clear that by the enactment of 1943 the Congress for the first time introduced into the statute key language which had not theretofore appeared either in the statute or in the regulations thereunder, namely, a new definition of 'gross income from mining' as including 'not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products.' Notwithstanding this, the Commissioner has subsequently sought, by regulatory amendments to § 29.23(m)-1(f) of Treas. Reg. 111, in cases where the mine owner customarily had to indulge in further processing other than merely extractive operations before obtaining a commercially marketable product upon which he could realize any income, to prescribe a relatively complex mathematical method for calculating the percentage depletion base. This would require an allocation of income derived from the sale of the first marketable product to the various treatment processes in proportion to their cost, with only those processes allowed as part of the base which occurred before any chemical change had taken place in the extracted mineral.

"By § 319 of the Revenue Act of 1951 (65 Stat. 497), the Congress amended § 114(b)(4)(A) of the Internal Revenue Code so as to extend the availability of percentage depletion for the first time to 'calcium carbonates,' which includes deposits of cement rock, the natural resource involved in the case at bar. The prescribed percentage for calcium carbonates was ten per cent of the gross income from mining the deposit." 244 F. 2d at 514–517.

are "the 'ordinary' normal ones applied by the non-integrated miner." (3) "The Congress," says *Cannelton*, "intended the integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication." And then the following significant statement is made:

> It would, of course, be permissible for such an [integrated] operator to calculate his "gross income from mining" at the point where "ordinary" miners—not integrated—disposed of their product.

Apparently for the foregoing reason (among others, perhaps) the cases relied on by the respondent in *Cannelton* were found not apposite, although no approval of their holdings was indicated. (*Cf.*: note 10, p. 90, *Cannelton, supra.*) Although but four cases are cited by name (*United States* v. *Cherokee Brick & Tile Co.*, 5 Cir. 1955, 218 F. 2d 424; *United States* v. *Merry Brothers Brick & Tile Co.*, 5 Cir. 1957, 242 F. 2d 708; *C.I.R.* v. *Iowa Limestone Co.*, 8 Cir. 1959, 269 F. 2d 398; *Bookwalter* v. *Centropolis Crusher Co.*, 8 Cir. 1959, 272 F. 2d 391), we assume that in addition to those cited by respondent in *Cannelton* there should be mentioned *Dragon Cement Company* v. *United States, supra; Townsend* v. *Hitchcock Corporation*, 4 Cir. 1956, 232 F. 2d 444; *United States* v. *Sapulpa Brick & Tile Corp.*, 10 Cir. 1956, 239 F. 2d 694.

In the *Dragon Cement* case, *supra*, the first circuit was persuaded that it "should not create a conflict with our brethren in other courts of appeal," and held that a taxpayer is entitled to a percentage depletion deduction based upon its gross income from cement, as that was the intention of Congress.

For that reason we look to the *post-Cannelton* decisions of other circuits. In *United States* v. *Portland*

Cement Co. of Utah, 1961, 293 F. 2d 826, the tenth circuit held that "cement rock" was "calcium carbonate;" and that the case should be remanded for consideration as to what are "the ordinary treatment processes normally applied by" cement rock "miners or operators in order to obtain the commercially marketable mineral product or products."

The government there, and here, concludes the ordinary treatment processes included in mining would terminate with the crushing operation, *for at that point the mineral can be shipped to a manufacturer for processing;* and that even if there be no market for crushed cement rock (because all cement rock miners are also cement manufacturers), for depletion purposes the taxpayer-manufacturer will be considered as purchasing from himself, as a miner, the raw material used in making cement.

It is true that in *Cannelton* the Court stated:

> The question in depletion is what allowance is necessary to permit tax-free recovery of the capital value of minerals. (364 U.S. at 86.)

As a declaration of the basic philosophy behind depletion allowances, this is true. But because of the closeness with which the case must be examined broad generalizations such as above cited must be explored. The Court's statement is true, in principle, but clearly Congress has failed to stop at any such point as capital value in dealing with the problem.

If by granting a depletion allowance the Congress had intended to simply permit tax-free recovery of the capital value of the minerals it need not have enlarged the categories of minerals to which percentage depletion allowances became applicable; *i.e.*, Congress could have continued to use the more compli-

cated cost or discovery depletion allowances.* But instead Congress became more and more generous with a certain class of taxpayers by enlarging the categories of minerals to which percentage depletions applied. We believe Congress must be held to have knowingly granted a more generous depletion allowance when it enlarged percentage depletion allowance applicability; *i.e.*, it knew full well that more than the mere capital value of the mineral would be recovered. This view would seem to be strengthened when § 114 (b)(4)(B) is read, for therein Congress allowed certain processes to be included in the allowance which go beyond the capital value of various listed minerals as they lay in the land in their raw state.

The Court in *Cannelton* stated:

> This position leads to the conclusion that respondent's mineral product has no value to it in the ground. If this be true, then there could be no depletion. One cannot deplete nothing. (364 U.S. at 88.)

In the instant case, the district court found that there was *no* market for taxpayer's mineral until such time as it was processed into finished cement. Perhaps the limestone had no value to taxpayer before this time; but Congress granted a depletion allowance on the "commercially marketable mineral product"—not the mineral lying in the ground in a raw state.

The Court in *Cannelton* goes on to say:

> If it [the depletion allowance] were extended as respondent asks, the miner-manufacturer would enjoy, in addition to a depletion allowance on his minerals, a similar allowance on his manu-

* For excellent discussions of the various types of depletion allowances, see *Oregon Cement Co. v. United States*, 1 Cir. 1957, 244 F. 2d 511, 514-515, and 4 Mertens, Law of Federal Income Tax § 24.04 (1960).

> facturing costs, including depreciation on his manufacturing plant, machinery and facilities. (364 U.S. at 88.)

In our opinion Congress necessarily recognized this very fact when it allowed certain processes, which require machinery, to be included in the computation of the percentage depletion allowance. What difference does it make whether the miner-manufacturer takes a deduction (on certain assets) in the form of a depletion allowance or as depreciation; he will get one or the other, but not both.[10]

The Court in *Cannelton* also stated:

> We believe that the Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for *fabrication*. [Emphasis added.] (364 U.S. at 89.)

In the instant case taxpayer is not a fabricator. If it used its cement to fabricate concrete or cement sewer pipe, clearly *Cannelton* would apply. If it had by-passed a market—as did the taxpayer in *Cannelton*—then also *Cannelton* would clearly apply; to the contrary, here the district court found there was *no* market (presumably either profitable or unprofitable) for taxpayer's limestone *until* it was processed into finished cement. As the Court in *Cannelton* stated in its footnote 10, supra: "For our purposes, we need not reach the question of whether in those [*e.g.*, cement] cases the minerals in place had any 'value' to be depleted . . ." Here the district court found that taxpayer did not have a commercially marketable mineral product until taxpayer had processed its limestone into finished cement. In *Cannelton* the taxpayer had a commercially marketable mineral product (albeit unprofitable) before it fabri-

[10] 4 Mertens, Law of Federal Income Tax § 24.02 (1960).

cated sewer pipes. We hold *Cannelton* to be distinguishable.

Congress gave us something of its view of *Cannelton* in passing recent legislation relating to the cement industry.[11] This legislation was passed in 1960 to give those integrated miner-manufacturers of mineral used to make cement an election to use a cutoff point to mining at the pre-kiln feed stage. The crucial phrase in this legislation seems to be the Congressional reference to "existing law" in the Committee Report[12] accompanying the legislation. This Report, in part, reads as follows:

> It is understood that for these prior years the Government may well contend that under the *Cannelton* decision the cutoff point for the minerals in question occurs at an earlier stage of processing than set forth in the previous rulings. On the other hand, it is understood that certain taxpayers in the cement industry take the position that the principles enumerated in the *Cannelton* case do not apply to them, and that they are entitled to depletion on the basis of finished cement for years prior to 1961. Under such circumstances there is a reluctance to settle cases for the past years on the basis of the published ruling and it is probable that in the absence of this amendment there would be continued and widespread litigation in this area.
>
> * * * In order to encourage the settlement of this question, section 7 of the bill as amended by your committee permits taxpayers mining minerals used in making cement to elect to apply, for the years prior to 1961, the cutoff point provisions adopted in the Public Debt and Tax Rate Extension Act of 1960. Under

[11] Section 1 of the Act of September 14, 1961, 75 Stat. 781, 74 Stat. 917.

[12] See 1961-2 Cum. Bull. 761, pp. 8-12.

this proposal, if a taxpayer failed to make the election, the cutoff point in his case for these years would be determined under existing law.

Appellant states that Congress enacted this legislation to grant relief from *Cannelton* as to particular groups of integrated operators. But, appellant argues, taxpayer did not elect the pre-kiln feed cutoff point; it elected instead to litigate for depletion on cement. And argues appellant "in [this] litigation, it [taxpayer] is claiming that *under Cannelton* it is entitled to even more than it could have received as *relief from Cannelton.*" [Emphasis appellants'.]

We do not infer, from the Committee Report, that Congress deemed *Cannelton* to be "the law" as to cement operators. We infer that Congress was silent as to what the "existing law" might be as to individual cement operators; we infer that Congress gave these taxpayers an opportunity to buy their peace, rather than pursue the long and expensive alternative of litigating in hopes of obtaining that which they thought was theirs. We infer that Congress offered a compromise which it considered fair, as an alternative to pursuing a course of litigation in hopes of proving *Cannelton* inapplicable and gaining a more advantageous cutoff point for mining.

Since depletion allowances were first granted by Congress, the executive and administrative branches have struggled to narrow—or eliminate—their use. When this question is presented to Congress, each time Congress answers by enlarging the applicability of depletion allowances; *i. e.*, Congress answers by becoming even more generous. In the light of the typical Congressional attitude on depletion allowances, we see no basis for the inference that, in its most recent legislation, Congress has reversed itself and has become less sympathetic to miners and miner-manu-

facturers. As stated by the Court in *Canadian* (and *Dragon Cement, supra*):

> We are not concerned with the validity of this theory or with the statutory policy. Our sole function is application of the congressional mandate. (364 U.S. at 81.)

As we have attempted to show above, *Canadian* does not apply to the fact issues presented in the instant case. Indeed, the Court there expressly stated that it was not disturbing prior law which, in part, related to the cement industry. This was done in plain language. Surely Congress considered such plain language. And it follows then that "existing law" for the cement industry (*i.e.*, for taxpayers operating within the same factual circumstances as taxpayer herein) must be deemed to be the *Dragon Cement* and first *Monolith* cases.

We come to this conclusion with reluctance, because of some doubt if it can be reconciled with the reasoning of the Supreme Court in *Canadian*.

It may well be that the Supreme Court will extend the underlying and basic philosophy with respect to depletion in the *Canadian* "clay" case to the "cement" cases. Thus far it has refused to do so. We believe

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Appellant contends that this court decided two cases, after *Canadian*, which support its position here. But these cases are clearly distinguishable *United States v. Basic Clay Products*, 1961, 285 F. 2d 215, and *Liddell v. Victorville Lime Rock Co.*, 1961, 292 F. 2d 127). (In saying this, we except the "marble" issue presented here and in the *Victorville* case, *supra*.) In *Basic Clay*, taxpayer mined six varieties of clay and the record there indicated that there was some evidence of crude clay sales, *i.e.*, a market for crude clay. In *Victorville*, taxpayer was not in the cement industry, and was found to have commercially marketable mineral products entirely different from the product found by the district court in the instant case, *i.e.*, certain minerals were commercially marketable without extensive treatment processes.

Congress has, "in its wisdom," gone beyond the bare concept that one cannot claim depletion on that which has no value in the ground, in defining what is depletable. Issues of public policy are involved. We are required to await one determination or another."[1]

We refer to the recent decision of the Supreme Court in the *James* case (*James v. United States*, 1961, 366 U.S. 213) resting upon a fundamental fairness to those charged with criminal acts, that prevented that Court making the new rule of *James* with respect to the taxability of embezzled funds retroactive so long as *Commissioner v. Wilcox*, 1946, 327 U.S. 404, was the law of the land (despite its previous "thorough devitalization" by *Rutkin v. United States*, 1945, 343 U.S. 130).

By the same reasoning, we do not believe a taxpayer should be denied for depletion on a nonsalable intermediate product of mining operations when he has in good faith relied upon appellate decisions which were not taken to the Supreme Court for final determination by the government.

We believe such thinking was at least partially responsible for the attempt made by Congress to enact legislation to encourage settlement of these depletion cases.

The district court, following this court's instructions given in the first *Woodlith* case, correctly held that it was unnecessary to decide whether taxpayer's limestone is "calcium carbonates" or "chemical grade limestone" (having ten and fifteen per cent depletion allowances respectively) because in any event taxpayer fell within the fifty per cent net limitation. Hence the remaining question is whether taxpayer's lime-

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[1] See concurring opinion of Judge Duniway in *Simons v. Madigan*, 9 Cir., — F. 2d — (No. 17513, decided January 23, 1962).

stone is either "calcium carbonate" or "chemical grade limestone," as found by the district court, or "marble" as contended by appellant, within the meaning of § 114(b)(4)(A).

The district court found the limestone in taxpayer's deposit to be commonly regarded as and understood to be either "calcium carbonates" or "chemical grade limestone" and that it was *not* commonly understood or regarded to be "marble" or "stone." The district court also found, *inter alia*, that the limestone was *not* "marble" or "stone" within the commonly understood commercial meaning of those terms. We cannot say that these findings are clearly erroneous. There is ample evidence in the record to support these findings. And what was said by this court in *Victorville*, *supra*, seems equally applicable here:

> The Senate Finance Committee, in reporting on paragraphs (i), (ii) and (iii) of Section 114(b)(4)(A), (i) of which includes "marble" in the five per cent depletion rate, (ii) of which includes calcium carbonate (ordinary limestone) in the ten per cent depletion rate, and (iii) of which includes "metallurgical grade limestone" and "chemical grade limestone" in the fifteen per cent depletion rate, states, "The names of the various enumerated minerals are, of course, intended to have their commonly understood commercial meanings." • • •
>
> This congressionally expressed intent has received judicial approbation and application. [Citations.]
>
> • • • • •
>
> The record reflects that appellee's deposit is not suitable for the production of dimension marble. • • • We find nothing in the legislative history to lead us to believe that Congress adopted a standard which would compel the classification of appellee's deposit as "marble"

> within the commonly understood commercial meaning of that term. (292 F. 2d at 432–433.)

We therefore believe the district court correctly held taxpayer's limestone to be "not marble" within the meaning of § 114(b)(4)(A).

Appellant's second contention urged in this appeal is that the district court erred in allowing taxpayer to include all of the processes which it used in making cement, and that its finished cement in bulk is its "commercially marketable mineral product" on which taxpayer is entitled to depletion.

Having concluded that *Cannelton* does not work a change as to taxpayer's circumstances as found by the district court, it seems well settled that cement is a "commercially marketable mineral product" within the meaning of § 114(b)(4)(A). This was held to be so in the *Dragon Cement* case and apparently was sufficiently settled for the government not to see fit to contest such a holding made by the district court in the first *Monolith* case. Though the district court decided both these cases prior to *Cannelton*, we believe it correctly held that taxpayer's finished cement in bulk is its first commercially marketable mineral product on which taxpayer is entitled to depletion.

Appellant's third contention need not be considered at length. Though we might well agree with the district court's conclusion that *res judicata* and collateral estoppel bar consideration of appellant's contentions, we too have preferred to go to the merits of the issues. We think the interests of the parties—and of the public—are better served by so doing.

In answer to appellant's last contention, we hold the district court correctly granted summary judgment.

Affirmed.

(Endorsed) Opinion Filed Mar. 23, 1962.

FRANK H. SCHMID, *Clerk.*

United States Court of Appeals for the Ninth Circuit

No. 16914

R. A. RIDDELL, DISTRICT DIRECTOR OF INTERNAL REVENUE, LOS ANGELES DISTRICT, APPELLANT

vs.

MONOLITH PORTLAND CEMENT COMPANY, APPELLEE

Judgment

Appeal from the United States District Court for the Southern District of California, Central Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California, Central Division and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

Filed and entered March 23, 1962.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

For percentage depletion allowable under this subsection, see section 114(b), (3) and (4).

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * * *

(4) [as amended by Sec. 145(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 319(a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In General.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

(iv) in the case of sulfur, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance from section 23(m) be less than it would be if computed without reference to this paragraph.

(B) [as added by Sec. 124(c) of the Revenue Act of 1943, c. 63, 58 Stat. 21, and amended by Sec. 304(d) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137, and Sec. 207(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906] *Definition of Gross Income from Property.*— As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes," as used herein, shall include the following: (i) in the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipita-

tion (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

* * * * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 118 (1939 Code):

SEC. 39.23(m)-1 [as amended by T.D. 6096, 1954-2 Cum. Bull. 69]—* *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*— * * *

* * * * * *

(e) As used in sections 114(b)(3) and 114(b)(4)(A) and §§ 39.23(m)-1 to 39.23(m)-19, inclusive, the term "gross income from the property" means the following:

* * * * * *

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation

* There are no final Regulations promulgated under the Internal Revenue Code of 1954. For proposed Regulations on this subject see 21 Fed. Register, part 8, pp. 8439, 8488-8452 (November 3, 1956).

treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which (sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

(f) (1) The term "ordinary treatment processes," as used in §§39.23(m)-1 to 39.23(m)-19, inclusive, shall include the following:

(i) In the case of coal—cleaning, breaking, sizing, and loading for shipment;

(ii) in the case of sulfur—pumping to vats, cooling, breaking and loading for shipment;

(iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering (agglomerating by incipient fusion) to bring to shipping grade and form, and loading for shipment;

(iv) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, products from the mineral. The furnacing of flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, or by substantially equivalent

processes or combination of processes used in the separation or extraction of the product or products from the mineral. The furnacing of quicksilver ores is included in the term "ordinary treatment processes." The following processes are not included in the term "ordinary treatment processes": Electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

(2) In addition, a treatment effecting a chemical change, the blending with other material, a thermal action, and the fine pulverization, pressing into shape or molding, are not included in the term "ordinary treatment processes" unless such processes are (i) otherwise provided for in subdivisions (i), (ii), (iii), or (iv), of subparagraph (1); (ii) necessary or incidental to the processes provided for in subdivisions (i), (ii), (iii), or (iv) of subparagraph (1), or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates).

(3) For the purposes of subdivisions (iii) and (iv) of subparagraph (1), the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

* * * * * *

(h) As used in paragraphs (e) and (f) of this section, the term "crude mineral product" means the product in the form in which it emerges from the mine or well.

APPENDIX C

United States Court of Appeals for the Fourth Circuit

No. 8577

VIRGINIA GREENSTONE COMPANY, INCORPORATED, APPELLEE

versus

UNITED STATES OF AMERICA, APPELLANT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF VIRGINIA, AT LYNCHBURG.

ALFRED D. BARKSDALE, *District Judge*

(Argued June 4, 1962. Decided September 24, 1962)

Before SOPER, HAYNSWORTH and BELL, *Circuit Judges.*

Melva M. Graney, Attorney, Department of Justice, (Louis F. Oberdorfer, Assistant Attorney General; Lee A. Jackson, Attorney, Department of Justice; Thomas B. Mason, United States Attorney, and Lawrence C. Musgrove, Assistant United States Attorney, on brief) for Appellant, and Frank G. Davidson, Jr., (Lapsley W. Hamblen, Jr., and Caskie, Frost, Davidson & Watts on brief) for Appellee.

HAYNSWORTH, *Circuit Judge:*

The question is the basis for the computation of the depletion allowance for income tax purposes for this miner manufacturer of dimension stone. The District Court held that sand finished stone, cut to the dimensions specified by the customer, is the first marketable product of the quarry and that depletion should be computed on the basis of the gross income from the sale of such stone. We think gross income from the sale of quarry block, as contended by the Commissioner, is the proper basis.

In Lynchburg, Virginia, the taxpayer mines, cuts and finishes greenstone for use as ornamental or dimension stone. The dressing or finishing plant is approximately a mile and a quarter from the quarry, and, during the years in question, all of the quarry blocks extracted from the mine were cut and finished in the finishing plant.

Greenstone is an actinolite-chlorite schist. By channeling and drilling, it is removed in large blocks from the quarry. These quarry blocks are transported by truck to the finishing plant. There, gang saws cut each block into slabs of the desired thickness usually varying, according to customer specification, between slabs of an inch and 3½ inches. The slabs are then cut to specified lengths and widths, after which their surfaces are smoothed and finished by sand rubbing.

The slabs of stone, thus precisely dimensioned as to length, width and thickness and finished, are known as sand finished greenstone. Some orders require further polishing, honing and buffing of the surfaces of the slabs. Some of the orders require notching and drilling of the slabs and some require that letters and numerals be carved into the outside surface of some slabs. Substantial orders are received for sand finished greenstone without further polishing, notch-

ing, drilling or carving, however, and the taxpayer contends that such stone is its first marketable product.

Greenstone, so dimensioned and finished, is used as a veneer stone on and in buildings. Orders are received by the taxpayer as a result of a specification of greenstone by an owner or an architect. They are accompanied by detailed specifications of the dimensions and the surface finishing processes which are desired. Thus all finishing operations are geared to the requirements of particular customers.

The taxpayer, of course, seeks to promote the use of greenstone rather than other dimension stone, such as marble or granite, with which it competes. This it does, in the main, through contacts with architects and engineers, the color being the principal selling point.

There is no other producer of greenstone in the United States. Since the taxpayer is the sole producer of such stone and actively promotes its use, it is not surprising that it is the recipient of the greenstone orders, and that in the years in question it sold no quarry block to others. On infrequent occasions it received inquiries about the sale of quarry block for processing in other dressing plants, but these were insignificant in the quantity of material involved. Plainly, there was no active market for Greenstone quarry blocks.

It does not follow, however, that the taxpayer could not have marketed its quarry block had it sought to do so. Some other finisher of dimension stone might well become a most willing purchaser of greenstone quarry block if given an exclusive arrangement and freedom from competition by the taxpayer's finishing plant. So long as the taxpayer operated as it did, no other finisher could afford the expense of pro-

moting and selling greenstone, and was unlikely to receive an order for it. Thus, there was reference to the Alberene Stone Company, another integrated Virginia producer of dimension stone, but its stone was soapstone and serpentine. It promoted its own products, as the taxpayer promoted the use of greenstone, and neither was interested in promoting the competing product. So long as they were in competition for the sale of their finished products, neither was a potential purchaser of substantial quantities of the other's quarry block. As the taxpayer's president put it, one would not likely be able to sell a truck load of new Fords to a Chevrolet dealer.

For all that appears, therefore, the absence of an active market for greenstone quarry block is attributable to the taxpayer's volition. It controlled the only source of supply, and it was in active competition in the finished products market with producers of other dimension stones. Had it been willing to sell its finishing plant to some entrepreneur and to supply his requirements of quarry block, the quarry block might have been readily marketable.

The testimony discloses that there are many producers of dimension stone which are integrated as is the taxpayer. However, there are many unintegrated quarries producing quarry block for sale to finishing plants. Thus it is clear that integrated producers of other dimension stones, such as marble and granite, must treat their quarry block as the marketable product of the mine, and that is true whether or not the particular producer could profitably dispose of his quarry block.[1] The taxpayer contends, however, that because its product is unique, produced only in its own quarry, the existence of markets for other di-

[1] *United States* v. *Cumberland Sewer Pipe Co.*, 364 U.S. 76, 80 S. Ct. 1581, 4 L. Ed. 2d 1581.

mension stone quarry blocks is irrelevant. In effect, it contends that it is a separable industry—the greenstone dimension stone industry and that its practices, for it is the industry, alone are relevant.

Mining operations, for income tax purposes, are entitled to percentage depletion based upon the gross income from the property at specified rates, though the allowable depletion may not exceed 50% of net taxable income from the property computed without a depletion deduction.[2] By definition, mining includes not only the original extraction of ores but "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *." The statute contains a list of processes which the Congress considered "ordinary treatment processes normally applied by mine owners." The list contains no reference to the finishing of dimension stone, but the list is nonexclusive.[3] The list, however, indicates the kind of things the Congress regarded as ordinary treatment processes. Generally, they appear to be processes appropriate for the miner and necessary for the production of a product which may be shipped to a manufacturer for further refining, processing, molding or fabrication.

Percentage depletion for the extractive industries has a long history, so often reviewed it need not be recounted here. It discloses a liberal congressional approach to the allowance of the deduction and to the inclusion of related processes within the compass of the favored mining operations. This fact led to de-

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[2] Internal Revenue Code of 1954, § 613.

[3] See, *e.g.*, *United States v. Cannelton Sewer Pipe Co.*, 364 U.S. 76, 80 S. Ct. 1581, 4 L. Ed. 2d 1581; *Oregon Cement Company v. United States*, 1 Cir., 244 F. 2d 513; *Riddell v. Monolith Portland Cement Co.*, 9 Cir., 301 F. 2d 488.

cisions that integrated miner-manufacturers were entitled to percentage depletion on the basis of the gross income from the sale of the first marketable product of the manufacturing processes if there was no active market in which the product of the mine could be profitably sold without conversion into manufactured products.

That approach was halted by the decision of the Supreme Court in *United States v. Cannelton Sewer Pipe Co.*[*] The taxpayer there was an integrated miner of fire clay and shale and a manufacturer of sewer pipe and other vitrified products. Fire clay and shale from strip mines was bought and sold in the area, but Cannelton's deposits were deep. The quality of its clay and shale was said to be exceptionally good, but its underground extraction was so expensive that Cannelton could not profitably dispose of it on the basis of established prices for clay and shale from strip mines. It claimed, therefore, that its first marketable product of its mine was its finished, manufactured product.

Cannelton's claim was rejected by the Supreme Court. It held that the statute required a distinction between mining and related processes, on the one hand, and manufacturing processes on the other. Cannelton's operation was treated as though, as miner, it had sold its extracted clay and shale to itself, as manufacturer, and its depletion base was held to be the gross income it constructively received from itself for the clay and shale.

Since Cannelton controls our conclusion, we need not be concerned with pre-Cannelton cases which may seem to point the other way. It is now settled that if a taxpayer is engaged in an integrated mining-manufacturing business, the depletion base is dependent

[*] 364 U.S. 76, 80 S. Ct. 1581, 4 L. Ed. 2d 1581.

upon a determination of the point at which mining and the ordinary treatment processes normally applied by mine owners cease and manufacturing begins.

In *Commissioner* v. *Halquist*, 7 Cir., 291 F. 2d 49, it has recently been held that the operation of a dimension stone finishing plant is manufacturing, not mining nor an ordinary process normally applied by miners. Halquist extracted dimension stone in large slabs from his quarry. In his finishing plant these slabs were cut, proportioned and processed for use as veneer dimension stone. Because there was a loss of 40% to 50% of the weight in the finishing process, it was not economically feasible to ship uncut stone, and, there being no other finishing plants nearby, the taxpayer contended that his finished dimension stone was the first marketable product of his quarry. Following Cannelton, the court rejected the contention. Since there were no area sales of uncut stone like Halquist's, the court turned to the general practices in the dimension stone industry for guidance in determining where Halquist's mining ended and his manufacturing began.

It did appear in Halquist that, where large blocks of dolomite from the same general formation worked by Halquist, were available, they were extracted and sold as quarry block, but Halquist had no such large blocks available. His uncut stone had physical properties which made it uneconomic to transport it to any other finishing plant.

Recently, we had occasion to consider ordinary treatment processes normally applied by mine owners. A quarry, from which very large blocks of granite for monumental use were extracted, was fourteen miles from the nearest railroad of a common carrier.

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[1] *Winnabara Granite Corporation* v. *Commissioner*, 4 Cir., 283 F. 2d. 307.

The quarry and the carrier were connected by a private railroad over which the stone moved. The stone was sold f.o.b. the carrier's station, and would have been unmarketable but for the maintenance and operation of the private rail line. We held that the cost of transporting the blocks to the railhead was not a part of the mining, nor was it an ordinary treatment process normally applied by miners.

Whatever may be said of the result reached in *Riddell* v. *Monolith Portland Cement Co.*, 9 Cir., 301 F. 2d 488, in the light of Cannelton, the holding in Riddell is not persuasive here. In holding that cement was the first marketable product of the cement rock quarry, the court emphasized the fact that all cement producers were integrated and none of them were in the market for crushed cement rock extracted from independent quarries.* Here, in contrast, it is clear that quarry block is a marketable product in the dimension stone industry, viewed as a whole.

What the taxpayer sells is the finished, manufactured product. When shipped by the taxpayer, it is ready for installation by stonesetters without further processing or treatment. The record discloses that dimension stone dressing plants, such as the taxpayer's, are classified by the Bureau of the Census of the Department of Commerce as manufacturing plants. Since many such plants are operated independently of any quarry and since many quarries produce and sell quarry block which others convert into dressed dimension stone, the classification is

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*Cement rock is a high grade limestone. It does not clearly appear from the court's opinion that crushed cement rock could have been sold for some other end-use than the manufacture of cement. If it could, though such disposition was not economically advantageous, Cannelton would seem to require a different result.

realistic and appropriate. The quarry block is the marketable product of the dimension stone quarry, being then fit for industrial use and further processing in the manufacturing plants, while the finished, dressed dimension stone is the marketable product of the manufacturing plant.

The taxpayer, of course, would avoid the thrust of this approach if its operations were considered in isolation. It contends they should be, because the stone in its quarry has unique chemical composition and coloration. Thus it says that whatever it does is normal and ordinary for the industry, for it is the sole representative of the industry.

The contention is unacceptable. The cogent fact is that the taxpayer is in direct competition with other producers of dimension stone. Though their products may be classified as marble, granite or other stone, not as greenstone, every variation in the physical or chemical properties of the material or in color does not require that its producer be treated as an isolated industry or that the practices of those in direct competition with it be disregarded. These differences in the materials do not alter the processes required to produce the finished product—dimension stone ready to be set and used; they furnish no rational basis for more favorable tax treatment of one competitor than another.

The statute should be applied on the basis of objective standards. The required determination of the ordinary treatment processes normally applied by miners, should not be converted into a subjective ascertainment of the practices, voluntarily undertaken, of a particular taxpayer. Unless variations in the materials, or in other factors, occasion variations in processes and procedures, miners in direct and immediate competition should be required to

compute percentage depletion on the basis of a determination of those treatment processes which are normal and ordinary as to all of them. The dimension stone industry need not be so fragmented that different standards should govern allowable depletion deductions because the product of one taxpayer is pink while that of another is green.

This seems the plain teaching of the Cannelton case. What this taxpayer has done is not controlling. The court must distinguish between what is mining within the meaning of the statute and what is manufacturing. That task is approached in the light of the practices of the industry of which the taxpayer is a part, and those industry practices are not made irrelevant by differences in the color or composition of the product when those differences do not require or result in variations in the treatment processes associated with mining.

Upon the undisputed facts, we conclude that the quarry blocks were the marketable product of the mine which were then fit in all respects for industrial use in the dressing plant, where manufacturing operations are conducted, the processes of which were not normal to the operation of comparable quarries nor ordinarily applied by comparable quarry operators. The result is that the taxpayer must be regarded as having sold the quarry blocks to itself and is required to compute allowable percentage depletion on the gross income constructively received upon such sales.

Reversed.

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